FINANCE, AUDIT AND PERFORMANCE COMMITTEE – 31 MARCH 2014

THIRD QUARTER TREASURY MANAGEMENT

REPORT OF DEPUTY CHIEF EXECUTIVE (CORPORATE DIRECTION)

Hinckley & Bosworth Borough Council
A Borough to be proud of

---

1. PURPOSE OF REPORT

To inform the Select Committee of the Council's Treasury Management activity during the first nine months of 2013/14.

2. RECOMMENDATION

That the Select Committee note the report.

3. BACKGROUND TO THE REPORT

At its meeting in February 2013 the Council approved the Council's Treasury Management Policy for the year 2013/14 and delegated the oversight of the execution of the Policy to the Select Committee.

This report sets out the Treasury Management activities for the first half of 2013/14 and shows that they are in line with the limits set out in the Policy.

Treasury Management covers two main areas:-

1. The management of day to day cash flows by way of short term investing and borrowing. Longer term investment opportunities may arise depending on cash flow requirements.
2. Management of the Council's Long term debt portfolio which is used to finance capital expenditure that cannot be immediately funded by internal resources (e.g. by Capital Receipts).

3.1 Economic Background

- The quarter ended 31st December saw:
  - Indicators suggested that the economic recovery is continuing; therefore growth forecast was updated to 3.4% for 2014.
  - Upgraded growth forecasts and quarterly Inflation. Inflation fell back to 2% in December

The February Report from the Bank of England stated that: -

The UK recovery has gained momentum and inflation has returned to the 2% target. Reduced uncertainty, easier credit conditions and the stimulative stance of monetary policy should support continued solid economic growth, with the expansion in demand becoming more entrenched and more broadly based.
Robust growth has not so far been accompanied by a material pickup in productivity. Instead, employment gains have been exceptionally strong and unemployment has fallen much more rapidly than expected. The headline unemployment rate is likely to reach the MPC's 7% threshold by the spring 2014. Even so, the Committee judges that there remains spare capacity, concentrated in the labour market.

Inflation is likely to remain close to the target over the forecast period. Given this, and with spare capacity remaining, the MPC judges that there remains scope to absorb slack further before raising Bank Rate. Moreover, the continuation of significant headwinds — both at home and from abroad — mean that Bank Rate may need to remain at low levels for some time to come.

Forward surveys are currently very positive in indicating that growth prospects are strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. This, therefore, means that labour productivity must improve significantly for this situation to be corrected by the warranting of increases in pay rates.

Credit conditions. While Bank Rate has remained unchanged at 0.5% and quantitative easing has remained unchanged at £375bn in 2013, the Funding for Lending Scheme (FLS) was extended to encourage banks to expand lending to small and medium size enterprises. The second phase of Help to Buy, aimed at supporting the purchase of second hand properties, started in earnest in January 2014. These measures have been so successful in boosting the supply of credit for mortgages, and so of increasing house purchases, (though levels are still far below the pre-crisis level), that the Bank of England announced at the end of November that the FLS for mortgages would end in February 2014. While there have been concerns that these schemes are creating a bubble in the housing market, house price increases outside of London and the south-east have been much weaker. The Bank does not feel that Bank Rate increases would be effective in reducing house price inflation in London as a large part of property purchase is being done as cash transactions and / or by foreign purchasers, and is aggravated by a major short fall in new housing supply compared to the level of demand. As for bank lending to small and medium enterprises, this continues to remain weak and inhibited by banks still repairing their balance sheets and anticipating tightening of regulatory requirements.

Inflation. Inflation has fallen from a peak of 3.1% in June 2013 to 2.0% in December. It is expected to remain near to the 2% target level over the MPC's two year time horizon.

AAA rating. The UK has lost its AAA rating from Fitch and Moody's but that caused little market reaction.

3.2 <u>Investment Activity</u>

The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time, then ensuring adequate liquidity, with the investment return being the final objective. Following the economic background above, officers are implementing an operational strategy which tightens the controls already in place in the approved investment strategy.

The Council's investment criteria, approved by Council in February 2013 are:-

- **Banks 1 - Good Credit Quality** – the Council will only use banks which:

  i) Are UK banks; and/or

ii) Are non-UK and domiciled in a country which has a minimum Sovereign long term rating of AAA.

And have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

i) **Short Term** – F1
ii) **Long Term** – A
iii) **Individual / Financial Strength –** C (Fitch / Moody's only)
iv) **Support** – 3 (Fitch only)

- **Banks 2 – Guaranteed Banks with suitable Sovereign Support –** In addition, the Council will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:

  - (a) wholesale deposits in the bank are covered by a government guarantee;
  - (b) the government providing the guarantee is rated "AAA" by all three major rating agencies (Fitch, Moody's and Standard & Poors); and
  - (c) the Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.

- **Banks 3 - Eligible Institutions** - the organisation was considered an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in Banks 1 above. These institutions were subject to suitability checks before inclusion.

- **Banks 4** - The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.

- **Bank Subsidiary and Treasury Operations –** the Council will use these where the parent bank has the necessary ratings outlined above.

- **Building Societies –** the Council will use all Societies which:

  i) meet the ratings for banks outlined above
  Or are both:
  ii) Eligible Institutions; and
  iii) Have assets in excess of £500m.

- **Money Market Funds** - AAA
- **UK Government** (including gilts and the DMADF)
- **Local Authorities, Parish Councils etc**
- **Supranational institutions**

Funds for investment come from the following Sources
a) Revenue Account Balances held by the Council
b) Earmarked Reserves and Provisions
c) Unapplied Capital Receipts
d) Cash flow balances - income received before expenditure needs to be incurred

As at 31 December 2013 the Council held the following investments totalling £11,299,000

Counterparty	Investment Date	Maturity Date	Amount	Interest Rate
Coventry BS	02/12/2013	02/01/2014	2,000,000	0.4100
Hinckley & Rugby BS	18/12/2013	17/01/2014	2,000,000	0.4000
Hsbc Call Account	31/12/2013	01/01/2014	1,149,000	0.3500
Nationwide BS	02/12/2013	02/01/2014	1,000,000	0.4000
Newcastle BS	16/12/2013	16/01/2014	500,000	0.3800
Principality BS	27/12/2013	27/01/2014	1,650,000	0.4000
Skipton BS	04/12/2013	06/01/2014	1,000,000	0.4000
Skipton BS	09/12/2013	09/01/2014	1,000,000	0.4000
West Bromwich BS	02/12/2013	02/01/2014	1,000,000	0.4500

Details of all investments held from April 2013 to December 2013 are included in Appendix A

Details of the weighted average investment to December 2013 are shown in the table below together with the average overnight, 7 day and 1 month London Inter Bank Bid (LIBID) as a bench mark to the rates received by the Council.

Period	**Weighted Average invested**	**Average period (days)**	**HBBC Average Return**	**Overnight LIBID**	**7 Day LIBID**	**1 Month LIBID**
April 13 to Dec 13	8,230,836	9	**0.3776**	0.3505	0.3580	0.3661

T
he figures above show that the Council received a rate of return that is compatible with the returns available in the market.

It also shows that the weighted average period is within the maximum set of 0.5 years.

Due to current economic conditions officers have decided to limit investment to a one month excluding weekends, and not to invest with banks other than with the Council's Bank. This together with mergers of Building Societies has meant the Counter Party invest list of organisations has shrank. Average investments returns are however still higher then the comparable inter bank rate (return of 0.3776% compared against 0.3661%).

3.3 <u>Borrowing Activities</u>

Long term borrowing to finance Capital Expenditure

Excluding the HRA self financing element the Council has a Capital Financing Requirement of around for the current year is £19m which arises from previous decisions to incur Capital Expenditure that was not financed immediately by internal resources e.g. Capital Receipts or Grants giving rise to the need to borrow to finance the expenditure. This borrowing requirement can either be met by long or short term external borrowing or by internal borrowing i.e. using the cash behind the authority's balances and reserves and foregoing investment income. At the present time the interest payable on long term borrowing is significantly greater than the returns the Council could expect on its investments and therefore the Council has adopted a policy of being "underborrowed" with only £3.3m of long term loans on its books. One year loans from the PWLB currently cost 1.59% so if the Council was fully funded with short term money and was receiving investment income of 0.4% there would be a cost of £202,000 pa. With 20 year rates at about 4.27% the additional cost would be £670,000pa. In these circumstances the Council has not undertaken any long term borrowing in the current year and has relied on short term borrowing to meet cash flow needs.

Additionally, as part of the Self Financing HRA Settlement £67.652m has been borrowed from PWLB. Repayment options have been discussed with members and were presented to the Executive on 13th March 2012. Repayments for principal amounts for these loans will commence in 7 years time. The loan will be repaid in equal instalments of £2.9414m over 23 yrs.

3.4 Short Term Borrowing (to cover cash flow shortfalls).

Some short term borrowing took place to cover temporary cash flow shortfalls. The movements are as follows:-

Amount outstanding at 1 April 2013	£000
Plus Total Amount borrowed to December 2013	£3,650,000
Less Total Amount repaid in year	£3,650,000
Amount outstanding at December	Nil

The average amount borrowed was	£30,821.92
Average period of loans	4 Days
Number of occasions	4
Average rate of interest paid	0.4411%

All borrowing was conducted with the Operational Limit set by the Council.

5. FINANCIAL IMPLICATIONS (IB)

Any variations to budgets resulting from borrowing investing activities are reported within the Outturn position.

5. LEGAL IMPLICATIONS (AB)

There are no legal implications arising directly from this report.

6. CORPORATE PLAN IMPLICATIONS

This report supports the following Corporate Aims

- Thriving Economy

7. CONSULTATION

None

8. RISK IMPLICATIONS

It is the Council's policy to proactively identify and manage significant risks which may prevent delivery of business objectives.

It is not possible to eliminate or manage all risks all of the time and risks will remain which have not been identified. However, it is the officer's opinion based on the information available, that the significant risks associated with this decision / project have been identified, assessed and that controls are in place to manage them effectively.

The following significant risks associated with this report / decisions were identified from this assessment:

Management of significant (Net Red) Risks		
Risk Description	Mitigating actions	Owner
Loss of investments due to failure of Counterparty	Ensure Counterparty is financially secure prior to lending by confining activity to institutions on a list of approved institutions based on credit ratings. Ensure that lending is for appropriate periods and amounts as per Counterparty list	I Bham I Bham

9. **KNOWING YOUR COMMUNITY – EQUALITY AND RURAL IMPLICATIONS**

Treasury management activities support all activities of the Borough Council and therefore impact on all areas of and communities within the Borough

10. **CORPORATE IMPLICATIONS**

By submitting this report, the report author has taken the following into account:

- Community Safety implications
- Environmental implications
- ICT implications
- Asset Management implications
- Human Resources implications
- Planning Implications
- Voluntary Sector implications

Background papers: Investment and borrowing records

Contact Officer: Ilyas Bham, Group Accountant ext 5924

Executive Member: Cllr Keith Lynch